

TEACHERS' RETIREMENT BOARD  
BUDGETS AND AUDITS COMMITTEE

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SUBJECT: Internal Audit Final Report  
Alternative Investment

ITEM NUMBER: 6

ATTACHMENTS:       

ACTION:                     

DATE OF MEETING: February 4, 1999

INFORMATION:   X  

PRESENTER:   Mr. Lee  

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We completed our review of the internal control over the Alternative Investment process. The review period covered new investments approved by the Investment Committee in 1997, cash flow activity of existing investments for the time frame of July 1, 1997 through October 31, 1997, the December 1997 reconciliation worksheet, and the accounting of management fees for selected funds. Our review disclosed the following matters, which required the Alternative Investment Unit's attention and action:

The Alternative Investment Policy needed to be revised to reflect the current environment of the Alternative Investments Unit. The Alternative Investment staff concurred with this finding and recommendation. The Alternative Investment Policy and procedures were later revised and approved at the STRS June 3, 1998 Investment Committee meeting.

The partnership legal file was not always consulted to determine the actual fund size of the investment prior to preparing the Alternative Investment Status Report. The fund size was incorrectly reported to the Investment Committee on December 1997 Monthly Status Report for 4 of the 8 funds reviewed. Alternative Investments reported the proposed rather than actual fund sizes on the Monthly Status Report for Blackstone Capital Partners III, FS Equity IV, OCM Opportunities Fund II, and Candover 1997 US No. 1.

The actual fund size for Black Stone Capital Partners III and Candover 1997 No. 1 could not be verified at the time of the audit due to lack of documentation. Staff concurred with the finding and recommendation. Corrective actions were taken to validate the fund size. The May 1998 monthly report presented to the Investment Committee meeting incorporated the revised figures. According to the Alternative Investment Staff, written documentation to support the general partner's commitment for Blackstone III and Candover 1997 were obtained and placed in appropriate files.

Management fees were being capitalized and not being recognized as an expense. Per management request, we reviewed the accounting procedure used for capitalizing and expensing management fees. For Alta V, Whitney 1990, and WCAS V, management fees were recognized as an addition to capital and not as an expense. Alta V had

\$1,947,290, Whitney 1990 had \$1,580,186 and WCAS V had \$3,730,698 of unamortized management fees in the capital account for the time frame of 7/92 through 4/97. For the three funds, the investment in the Capital Account was overstated by the amount of management fees. We recommended the separation of expenditures from investment to allow STRS to compute the return of investments. Staff concurred with the finding and recommendation and has taken corrective action.

Capital call requests for funds were processed (wired) upon receipts of facsimile, photocopy, and unauthorized documentation. Evidence of staff's verbal confirmation to the general partner to ensure that the capital call request is authentic is not always documented on the capital call request. We recommended that staff establish a procedure to identify authorized personnel who have been given the authority to sign capital call requests on behalf of the general partner prior to wiring funds. In addition, staff should request the employee's name, position title, and specimen signature of all employees who are authorized to sign capital call requests. Staff concurred with the recommendation and has taken corrective action.